

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

**BRIEF AND APPENDIX FOR
PETITIONERS**

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT.

No. 10447

142

DAVID S. HENDRICK, ET AL., *Petitioners,*

v.

DISTRICT OF COLUMBIA, *Respondent.*

On Petition for Review of a Decision of the Board of Tax
Appeals for the District of Columbia.

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TABLE OF CONTENTS.

	Page
JURISDICTIONAL STATEMENT	1
STATEMENT OF THE CASE	2
STATUTE INVOLVED	5
STATEMENT OF POINTS	7
SUMMARY OF ARGUMENT	7
THE ARGUMENT	9
History of Early Trading Seat or Exchange	9
New York Stock Exchange History	12
Applicable Decided Cases on Stock Exchanges	15
Restricted Scope and Activities of W. B. Hibbs & Company Preclude Incorporation	18
THE BOARD'S DECISION	23
CONCLUSION	26

TABLE OF CASES CITED.

CASES:

<i>Sibbald v. Bethlehem Iron Co.</i> , 83 N. Y. 378 (1881)	8
<i>Potts v. Turner</i> , 6 Bing. 702, 706 (1830)	8
<i>Nicol v. Ames</i> , 173 U. S. 509, 517	8
<i>Balton v. Hatch</i> , 109 N. Y. 593, 596	15
<i>Garriques Co. v. New York Produce Exchange</i> , 213 App. Div. 625, at page 623	17
<i>In re Stringer</i> , 253 Fed. 352, at page 354	17
<i>Merchants National Bank v. The State National Bank</i> , 77 U. S. 604, 651	25

STATUTES:

District of Columbia Revenue Act of 1937, as amended by Act of May 16, 1938 (52 Stats. 371, c. 223; Title 47, Secs. 2403 and 2404, D. C. Code, 1940 Ed.)	2, 3, 7
---	---------

	Page
District of Columbia Income and Franchise Tax Act of 1947, approved July 16, 1947, Pub. Law 195, 80th Cong. under Title VIII.....	5
District of Columbia Revenue Act of 1947 (D. C. Code 1940, Supp. VI, sec. 47-1547b).....	7
MISCELLANEOUS:	
The Century Dictionary and Cyclopedia, Vol. 1, p. 783.....	24
Meeker's Book "The Work of the Stock Ex- change".....	9, 12, 17
Constitution of the New York Stock Exchange..	19, 25

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BRIEF FOR PETITIONERS.

JURISDICTIONAL STATEMENT.

This proceeding was brought to review a decision of the Board of Tax Appeals for the District of Columbia, holding that petitioners, as stock-brokers, are liable for the District of Columbia unincorporated business franchise tax for the year 1947. The jurisdiction of this Court is invoked under the provisions of Sections 3 and 4, Title IX of the

District of Columbia Revenue Act of 1937, as amended by the Act of May 16, 1938 (52 Stats. 371, c. 223; Title 47, Secs. 2403 and 2404, D. C. Code, 1940 Edition), as amended.

STATEMENT OF THE CASE.

Petitioners, David S. Hendrick, James C. Elgin, J. Carl Perry, Paul P. Rodler, John J. Dunn, and James A. Bruen, compose a partnership trading as W. B. Hibbs & Company. The partnership was formed July 1, 1947. It is the successor of a partnership of similar name formed in 1944. The articles of partnership of both firms are identical, except as to the names of the partners and the provisions as to the apportionment of profits and losses. The petitioners, John J. Dunn and James A. Bruen, were not members of the former partnership.

By the articles of partnership it was agreed that the business of the partnership shall be to buy, sell, and deal in stocks, bonds, grain and other securities and commodities, and to carry on a general brokerage, stock exchange and commission business.

In 1947 the activities of the firm consisted of buying and selling stocks, bonds and securities as brokers, on the New York Stock Exchange, the New York Curb Exchange, the Washington Stock Exchange and over the counter, and in the buying and selling of grain on the Chicago Board of Trade.

Petitioner Hendrick is a member of the New York Stock Exchange, the New York Curb Exchange, the Washington Stock Exchange and the Chicago Board of Trade; petitioners Elgin and Rodler are members of the Washington Stock Exchange. The partnership is not a member of any of these exchanges, but as between the petitioners and the partnership, these memberships are assets of the partnership.

To be able to do business on these exchanges a person must be a member of such exchange. No such membership is required for acting as broker in "over the counter" transactions. An over the counter transaction by a broker

as such, consists of buying securities from the owner or selling to the purchaser, not through a stock exchange, for the account of a principal, and charging the principal a commission on such purchase or sale.

Petitioners have not acted as principals in purchase and sale of securities.

During 1947 the gross income of petitioners was \$234,528 composed as follows:

Commissions on New York Stock Exchange	64%
Commissions on New York Curb Exchange	6%
Commissions on over the counter transactions . . .	7%
Commissions on grain transactions	2%
Interest on margin accounts	20%
Miscellaneous	1%

The interest item was to a great extent based on money owing to petitioners on margin accounts on securities which the firm had brought on the New York Stock Exchange.

Petitioners' total commissions during 1947 were \$185,491 composed as follows:

On New York Stock Exchange	82%
On New York Curb Exchange	7%
Over the counter	9%
Grain	2%

Petitioners' total expenses during 1947 were \$152,434. These expenses were not allocated among petitioners' various activities.

The New York Stock Exchange has been in existence since 1817. It has always denied membership to corporations.

The Rules of the Board of Governors of the New York Stock Exchange provide, that whenever it appears that a member or a member firm or partner thereof has such business connection with a corporation that the corporation dominates the policy of such business, the Board of Governors may require a discontinuance of such business con-

nection; that, without the consent of the Exchange, no member or member firm can act as a broker for any corporation if such corporation is controlled by such member or firm or by a partner of such firm, and is itself engaged in the business of buying and selling securities as a broker; that if a member or his firm or partner of a member is an officer, director, employee, or stockholder of a corporation engaged in the business of buying and selling securities for its own account or as broker, such member shall not participate in any commission paid by such corporation unless either such member or his firm is engaged in the general brokerage business and as such actively participates in the transaction on which such commission is paid; and, that without the consent of the Exchange, no member or member firm shall permit any corporation engaged in the business of buying and selling securities for its own account or as broker, to use as its office the office of such member or firm, or to employ in its business the same business organization as that employed by such member or firm, or permit any such corporation to conduct its business under a name that does not thoroughly differentiate such corporation from such member or firm. The Rules further provide that if a member or member firm or partner thereof controls a corporation engaged in the business of buying and selling securities for its own account or a broker, such member or firm shall be responsible for any fraud committed by such corporation.

It is contrary to the Rules of the New York Stock Exchange for members thereof to charge less than the commissions prescribed by that Exchange, or to allow any rebate, return, discount or allowance; consequently, a person who is not a member of the Exchange or a firm not affiliated with the Exchange through one of its members who is a member of the Exchange, would not make any money on transactions through the New York Stock Exchange, except by making a charge to its customers in addition to the usual brokerage. This would put it in an unfavorable competitive position compared to other brokers one or more

of whose members were members of the Exchange, and such firm would probably not be able to obtain any substantial amount of such business.

On December 20, 1948, petitioners applied to the Assessor for an unincorporated business license for 1949. The Assessor refused to issue such license, because petitioners had not filed an unincorporated business franchise tax return for 1947. Petitioners thereupon, on January 26, 1949, filed such return and paid the tax thereby shown to be due, namely \$975.29. On February 3, 1949, they paid \$274.87, covering interest and penalty, a total of \$1,250.16. These payments were made under protest.

On February 23, 1949, petitioners filed their appeal herein, upon the ground that they were not liable for the unincorporated business tax, by reason of the fact that they were engaged in a trade or business which by law, custom, or ethics cannot be incorporated.

On July 12, 1949, petitioners filed with the Assessor a claim for refund of said tax, interest and penalty. On July 13, 1949, the claim was denied by the Assessor. On July 19, 1949, petitioners filed herein their supplemental petition in which they recited the filing of their claim for refund, and the denial thereof.

STATUTE INVOLVED.

Under the District of Columbia Income and Franchise Tax Act of 1947, approved July 16, 1947, Public Law 195, 80th Congress, under Title VIII, it is provided:

"TAX ON UNINCORPORATED BUSINESS

"Sec. 1. Definition of Unincorporated Business.—For the purposes of this article (not alone of this title) and unless otherwise required by the context, the words 'unincorporated business' mean any trade or business, conducted or engaged in by any individual, whether resident or nonresident, statutory or common-law trust, estate, partnership, or limited or special partnership, society, association, executor, administrator, receiver, trustee, liquidator, conservator, commit-

tee, assignee, or by any other entity or fiduciary, other than a trade or business conducted or engaged in by any corporation; and include any trade or business which if conducted or engaged in by a corporation would be taxable under title VII of this article. *The words 'unincorporated business' do not include any trade or business in which by law, customs, or ethics cannot be incorporated * * ** (italics added).

Under the regulations pertaining to income and franchise taxes, promulgated by the Commissioners of the District of Columbia, on August 28, 1947, it is provided by Section 8-1(d), page 12, as follows:

"To be exempted from the tax imposed upon unincorporated trades or businesses rendering personal services the following requirements prescribed by law must be met:

"(1) Any trade or business which by law, customs or ethics cannot be incorporated.

"(a) Any trade or business in which more than 80 per centum of the gross income is derived from the personal services actually rendered by the individuals or members of the partnership or other entity in the conducting or carrying on of such trade or business *and* in which capital is not a material income-producing factor.

"If the trade or business meets the requirements set forth in item (1) above, it is thereby exempted without the need of meeting the requirements set forth under item (2). Title 2, District of Columbia Code, 1940 edition, prohibits the incorporation of certain occupations including dentistry, dental surgery, podiatry, and certified public accountants. In addition to the aforementioned occupations, practice of any of the following professions is recognized under these regulations as a trade or business which by customs or ethics is not incorporated, and such profession is exempted from the tax:

Accounting
Chiropody
Law
Medicine and surgery"

STATEMENT OF POINTS.

1. The petitioners, as partners, engaged in the stock brokerage business, could not *by custom* of the *trade* incorporate, and were required by the rules of the New York Stock and other Exchanges of which they were members to carry on their business as a partnership.

2. Petitioners are not subject to the unincorporated business franchise tax imposed by Article I, Title VIII, Sec. 3, of the District of Columbia Revenue Act of 1947 (D. C. Code 1940, Supp. VI, sec. 47-1574b), because the businesses upon which the tax is levied do not include "any trade or business which by law, customs or ethics cannot be incorporated".

3. The Board of Tax Appeals has given the above term of the taxing statute an erroneous interpretation, and the Board's application of its own interpretation to the business of petitioners is unjustified and contrary to the facts and law of the case.

4. The Board of Tax Appeals has failed to give effect to the fact that during the year in question 85 percent of the business of petitioners was derived from their membership in the New York Stock Exchange, which is restricted in membership to natural persons, and without such membership they could not stay in and do business.

SUMMARY OF ARGUMENT.

By far the greater part of purchases and sales of stock and other securities is made through organizations especially formed for that purpose and called stock exchanges. A stock exchange is a place of business where those who make up the membership of the exchange buy and sell stocks and bonds. These persons are called stockbrokers. A stockbroker is one who buys and sells stock as the agent

of another, the latter being called a customer of the stock-broker.

In *Sibbald v. Bethlehem Iron Co.*, 83 N. Y. 378 (1881) Finch, J. favors the definitions from *Potts v. Turner*, 6 Bing. 702, 706 (1830) where a broker is defined as "one who makes bargains for another and receives a commission for so doing." Story on Agency, Sec. 28 (9th Ed.) says: "The true definition of a broker seems to be that he is an agent employed to make bargains and contracts between other persons, in matters of trade, commerce, or navigation, for a compensation commonly called a brokerage."

The stock brokerage business has evolved from the market place which is as old as civilization itself. History reveals that trading was always conducted by *individuals*, and this is true of the present day stock exchange, where it has been and is the custom for *individuals* to act as brokers.

The nature of the leading exchanges of our country, and particularly the New York Stock Exchange, has frequently come before our courts, and it has been uniformly held that the stock exchange is a voluntary association of individuals, united without a charter, in an organization for the purpose of affording members thereof certain facilities for the transaction of their business as brokers in stocks and securities. (*Nicol v. Ames*, 173 U. S. 509, 517).

Petitioners, W. B. Hibbs & Company, in the taxable year in question, limited their business to the execution of orders to purchase or sell securities as agent only. In order to conduct this activity they held seats in the names of certain of the partners in the New York Stock Exchange, the New York Curb Exchange, the Chicago Board of Trade, and the Washington Stock Exchange. They were precluded by the rules of the New York Stock Exchange, with which they do over 85 percent of their business, from incorporating, and without the New York Stock Exchange business, petitioners could not maintain their business and survive.

The Board of Tax Appeals failed to recognize the nature and limited scope of petitioners' trade, which can be con-

ducted as partners only and not as a corporation, and has wrongfully interpreted and applied the term "law, customs or ethics".

THE ARGUMENT.

History of Early Trading Seat or Exchange.

The body of the law relating to brokers who deal in securities on exchanges is derived from three sources: (1) judicial decisions; (2) statute, and (3) exchange rules. The authoritativeness of the first two of these sources is obvious. The third is of equal importance by reason of the judicial sanctions which it has been accorded. The rules of an exchange constitute a contract between the members of the exchange. They enter into and form a part of every purchase and sale made on the exchange. As between members of the exchange, therefore, they have the force of law.

If there is any trade or business which by custom is prohibited from incorporation, it is the stockbrokerage business. It is part and parcel of the organized security market of the country, which functions under well defined and established rules.

An interesting authoritative and apt work on the subject of the antiquity of markets, which embraces the stockbrokerage business, is found in Meeker's book, "The Work of the Stock Exchange", referred to in petitioners' testimony at pages 54, 55. Therein he states:

Antiquity of Markets.—To establish markets is one of the most ancient and fundamental instincts of civilization. From the earliest times the development of industry has necessarily been accompanied, step for step, by the constant creation and expansion of markets which could distribute the products of industry. Even in darkest Africa the natives, still in a state of savagery, are perfectly accustomed to market places, where the buyers and sellers among them can meet to barter with each other their simple products of the chase and the fields. The oldest civilizations of the world had established market places before written

history began. The battered temple pylons of ancient Egypt, for instance, show us the fisherman, the weaver, the potter, the poulterer, the farmer, and the metal-worker, bartering their several products in market places centuries before currency was invented.

"The markets of the classical world, developing from equally crude and primitive trading, attained a broader scope and a higher degree of organization, and played a more significant part in the process of civilization, than historians seem to appreciate. The famous Agora, long the center of Athenian political life, where the just Aristides and the shrewd Themistocles were ostracized from the state, was originally a market place which had sprung up at the foot of the Acropolis where the seven roads of Attica converged. Long before Solon instituted the Athenian coinage system, the fisherman from the Piraeus bartered his fish here for the barley of the Attican farmers.

"The Roman Forum.—Such, too, was the origin of the great Forum of Rome, the most famous spot in classical antiquity. For half a thousand years all European civilization was ruled from this place. But long before there was any Roman state and while the Romans were still a small and struggling provincial people, this forum had been a market place for cattle. Before the dawn of history the Campagnian peasant drove his herds into what was later destined to be the political center of the world, to barter them for the goods of other traders who also congregated there. There being no currency, goods were at first valued according to the number of cattle they sold for—a custom which was responsible for the derivation of the Latin word *pecunia* (money) from *pecus* (a herd).

* * * * *

"Marketing in Imperial Rome.—The purchase and sale of debts and money were conducted in Imperial Rome, and perhaps even earlier in republican Athens. It is interesting to note that even in ancient Rome the financial and commercial markets were already clearly differentiated. Of the nineteen *fora* of Rome, those devoted to the purchase and sale of commodities were known as the *fora vendalia*, while the bankers and usurers (or *argentarii*) used to take their stand in the

fora civilia or *judicialia*, where political activity centered and where popular assemblies and courts of justice were held. The chief forum of Pompeii reveals to the modern tourist an imposing building where the local money-lenders used to conduct their business.

* * *

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“Evolution of the Market Place.—The earliest and simplest markets were formed by the congregation in one place of buyers and sellers, driven together by the economic necessities of trade. These original markets did not in the beginning specialize, but dealt in all kinds of goods and were located for the most part in the open places of a town. Farmers drove in from the country with foodstuffs to sell, weavers displayed their textiles, and smiths their manufactured articles. In time, money-lenders and merchants in credit also came to take part in the market, and facilitate its operations. Markets of this primitive type, at least in food-stuffs, still exist in some American and European cities, and are common in the bazaars of the immemorial East.

“But as communication became easier, population (and hence the consumption of goods) greater, political and social conditions more stable and tranquil, and the volume of trading larger, a process of specialization began. At first, of course, this tendency appeared within the single original market place itself. Traders in textiles took their stand in one part of it, traders in foodstuffs in another. Sometimes, in the early international markets of Europe, the division was not so much according to the commodity as the nationality of the dealers. But with the increase in trading, certain commodities which experienced the heaviest trading tended to break away from the single original market, and form separate markets exclusively for themselves.

“At first these specialized markets were often conducted in the open streets. But with a further increase in their transactions they have tended to assume the more dignified title of ‘exchanges,’ and finally to go under a roof with restrictions upon the membership. In the course of the same evolutionary process, the development of trading in contracts for the receipt and delivery of given commodities on the floors of these ex-

changes or *bourses*, made it unnecessary to bring into the market place every individual object to be sold. The development of security certificates as evidences of the ownership of a public or a business debt, or of business equities, of course greatly facilitated the development of organized capital markets, or stock exchanges. As time went on, increasingly strict and inclusive rules were adopted to govern the character of trading on the exchanges, and also methods were gradually established for periodically clearing and settling such exchange contracts in the most efficient and economical way."

As is apparent from the above historical narrative, from time immemorial it was the custom for individuals to act as brokers, and this practice has prevailed to the present day.

New York Stock Exchange History.

The following is another excerpt from Meeker's Book, *supra*, showing the evolution of the New York Stock Exchange, which is believed to be informative and pertinent to the issue here:

"Earliest New York Markets.—New York was founded by the Dutch in 1623, not as an asylum for religious or political freedom, but as a trading post. Owing to its splendid natural port facilities, the city had, early in the eighteenth century, become a commercial center of no small importance. Its merchants from the first possessed both energy and vision. As early as 1752, in fact, they had established a general meeting place for merchants, or 'Exchange' as they called it, at the foot of Broad Street, for dealings in meal and water-borne produce. An even more significant market place was established on the wharves at the foot of Wall Street (now near the intersection of Pearl Street), where the manufactured goods of Europe were unloaded from incoming boats from abroad, and auctioned off to local merchants. In 1768 the present Chamber of Commerce was organized in the long room of Fraunces' Tavern, which still remains in the financial district as a reminder of pre-Revolutionary Manhattan.

"Prior to and during the Revolutionary War, there was no security market in New York, for the excellent reason that practically no securities existed in colonial America. Such capital as then existed flowed into land or goods. Only occasionally did American cities issue bonds; company shares were also thoroughly exceptional, since most business was conducted by individuals or partnerships rather than by stock corporations. In any case, however, the financial facilities of imperial London, capital of the British Empire, were available to British colonies, and until American independence was won, there was no need of creating rival facilities in the new colonial towns of New York, Philadelphia, or Boston.

"These conditions, however, disappeared with British rule. The Revolution had created a heavy American national debt. The first Congress assembled in Federal Hall (where the historic New York sub-treasury building now stands, diagonally across Wall Street from the present New York Stock Exchange Building), and authorized the issue of \$80,000,000 in bonds, or 'stock' as it was then called, to consolidate a new form of war debt. Thus there came into existence a new form of property, in an amount enormous for those days, for which no regular market existed.

"Meanwhile, the financial necessities of the new Republic were leading to the creation of a new financial machinery. In 1781 the Bank of North America was incorporated in Philadelphia. Not to be outdone even by what was then the Commercial and financial center of the country, the merchants of Manhattan organized the Bank of New York in 1784. But a still more significant step was yet to be taken. In 1791 Alexander Hamilton, a New Yorker and the first Secretary of the U. S. Treasury, prevailed upon Congress to establish the first United States Bank.

"Origin of the New York Securities Market.—The scrip stock of this new institution, when it was offered to the public, inaugurated the first wave of security speculation in this country, in which the 6% United States Government stock as well as the shares of the new United States Bank and the Bank of North America were favorites. The frequent purchases and sales

of these early American securities created the need of some regular market where they could be more readily and efficiently conducted, for investors were naturally averse to exchanging their savings for securities which could not be easily sold again.

“The earliest records of security marketing in New York are meager and obscure. Apparently, securities were first sold in the ordinary produce and merchandise auctions at the foot of Wall Street—then the chief wholesale markets of the city. But auctions by their very nature are one-sided markets, with competition between buyers, but none between sellers. For this reason, auctioning did not prove an adequate method for marketing securities, despite the fact that security auctions are still held in New York. Also, due to public unfamiliarity with securities, about ten auctioneers and merchants were attracted into the new occupation of acting as agents and brokers for security buyers and sellers. These earliest New York stockbrokers, according to tradition, formed the custom of meeting under an old buttonwood tree which then stood before what is now 68 Wall Street, except when inclement weather drove this tiny curb-market to shelter in the nearby coffee houses. Thus they became accustomed to transact their business with each other and for the public, and to provide as well as they could the ready security market for which the times called with increasing insistence. And thus, for all its present splendid facilities, the New York securities market began very humbly indeed in the rain and dust of a village street.

“First Brokers’ Agreement.—The first sign of an organization in this original open-air market was manifested on May 17, 1792, when the following agreement, still preserved in the archives of the Stock Exchange, was signed by these early brokers:

“We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other that we will not buy or sell, from this day, for any person whatsoever, any kind of public stock at a less rate than one-quarter per cent commission on the special value,

and that we will give preference to each other in our negotiations.

“There are 24 signatures to this interesting document, which is the first stock exchange agreement of any kind in this country.

“The stock market thus inaugurated grew rapidly. After playing a vital part in the creation of our earliest banks, the fire and marine insurance companies were likewise presently enabled through its agency to obtain necessary capital. State and municipal obligations were shortly added. The War of 1812 resulted in heavier government debt, more government bonds, and a heavy increase in their purchase and sale in the New York securities market. So rapidly did the security brokerage business grow that steps soon had to be taken not merely to provide for the greater dignity and comfort of the stockbrokers themselves, but also to protect their contracts more completely by restricting membership in the market. To this end the New York street brokers went under a roof for the first time in 1817, and as a part of the further organization which this move necessitated, took for themselves the collective name of the ‘New York Stock and Exchange Board.’ The first constitution of this new organization bears the date of March 8, 1817, and among other matters provides that ‘any members making a fictitious sale or contract shall, upon conviction thereof, be expelled from the board.’ At this time trading was permitted in only about 30 stocks, and the new association was formed by only 7 firms and 13 individual brokers.”

Applicable Decided Cases on Stock Exchanges.

The nature of the leading exchanges of the country has frequently come before the courts for consideration and definition. The New York Stock Exchange has been judicially described in the leading case of *Balton v. Hatch*, 109 N. Y. 593, 596, as follows:

The New York Stock Exchange is a voluntary association of individuals, united, without a charter, in an organization for the purpose of affording to the mem-

bers thereof certain facilities for the transaction of their business as brokers in stocks and securities, and a convenient exchange or sales-room for the conduct of such transactions. It cannot be said to be strictly a copartnership, for its objects do not come within the definition of one. A copartnership results from a contract between the parties by which they agree to combine their property or labor, or both, in some common enterprise and for a common profit, to be shared in the proportion stated in their agreement. The objects of a voluntary association of brokers do not, however, involve any such combination, or any communion of profits from the business transacted by the members. Like a business club, its principal object is the promotion of the convenience of its members by furnishing facilities which aid them in doing their business, and are, therefore, of benefit to them. It may be said, however, that the rights of the associates are not substantially different from those of partners, so far as their rights in the property of the association are concerned. The interest of each member in the property of the association is equal, but it is subject to the constitution and by-laws, which are the basis on which is founded the association. They (the constitution and by-laws) express the contract by which each member has consented to be bound, and which measures his duties, rights and privileges as such. It seems most clear to me that this constitution and the by-laws derive a binding force from the fact that they are signed by all the members, and that they are conclusive upon each of them in respect of the regulations of the mode of transaction of his business, and of his right to continue to be a member. Whatever are the rights acquired by a member and created by his admission to membership, the rules by which the membership is created or dissolved, and which control the affairs of the organization and the relations of members, entered into those rights when created and remained a part of them. In this proposition there is nothing against public policy, for the reason that whatever a member acquires is subject to the self-imposed condition that his title and the rights which accrue from his membership are regulated by, and are dependent upon the laws adopted by

the association, and expressly consented to by him when he joined."

In *Garriques Co. v. New York Produce Exchange*, 213 App. Div. 625, at page 623, the Court said:

"Under the charter and by-laws of the appellant (New York Produce Exchange) only such persons as have been regularly elected to membership therein may receive certificates of membership. *The plaintiff never was elected to membership in the appellant and, as already noted, by reason of being a corporation it is not eligible to election to membership.* To compel the appellant, therefore, to issue a certificate of membership to the plaintiff or to its nominee, would be requiring the appellant to do an act in violation of the provisions of its charter and by-laws, and in effect be forcing a new and additional member upon the appellant or requiring the issuance of an extra certificate if issued to a person already a member. To such relief the plaintiff is not entitled, since any interest of the plaintiff in the appellant or in any certificate of membership therein necessarily is subject to the provisions of the charter and by-laws of the appellant." (Italics added.)

In *re Stringer*, 253 Fed. 352, at page 354, the Court said:

"The record shows that a rule of the Stock Exchange requires a membership in that *organization to be an individual membership*, and not a firm membership. The firm has no right to appear on the floor of the Exchange, but the membership as an asset of the firm is liable for any debt contracted by any member, and the Exchange regarded and treated Stringer's membership as an asset of the firm of Stringer & Co. * * *" (Italics added.)

An explanation for the denial of membership to corporation is found in Meeker's work, *supra*, where, on page 652, he states:

"CHAPTER XVI—The Administration of the Stock Exchange

“(XVIa) Stock corporations have always been denied membership, not only in the New York Stock Exchange, but also in the Stock Exchange of London and the Paris Bourse. In the German-speaking countries, incorporated banks are permitted to engage in business on the exchange floor; it should, however, be noted that membership in the Berliner Borse or the Wiener Borse does not mean the same thing as in the exchanges of the English-speaking countries.

“The prohibition against incorporated members has been due partly to the particular evolution of financial methods in this country, and partly to fundamental conceptions of the proper status and functions (as contrasted with the unlimited liability of individuals and partnerships) in cases of insolvency, would prove a hindrance to free market dealings, and perhaps an incentive to over-risky business methods. There is also the feeling in both England and this country that it is better both for the stock market and the money market to have stock brokerage organized as a specialized business separate and distinct from commercial banking. This attitude, from the American standpoint, can find adequate justification from the example of the Berlin market, whose commission business has been largely swallowed up by a few powerful incorporated banking institutions. In proportion as this development has occurred there, the Berlin broker has degenerated into a mere taker and handler of orders from these few great banks on the Borse floor.

“This evolution in Berlin has resulted there in an actual ‘money trust,’ and prevented the development of a ‘free and open’ market of the type maintained by the stock exchanges of New York and London.”

Restricted Scope of Activities of W. B. Hibbs & Company Preclude Incorporation.

A considerable difference exists between the various commission houses in the scope and variety of the service they render the public. The evidence in this case establishes that petitioners, as stockbrokers, limited their business to the execution of orders to purchase or sell securities *as*

agent only on a fixed commission. Petitioners make their livelihood out of the commissions paid to them by the purchasers and sellers whom they represent. In order to carry on this type of business, they must hold a membership in a stock or commodity exchange. Such membership, or, as it is colloquially called, "a seat" involves mainly two things: (1) a personal privilege to transact business on the exchange, and (2) a property right in the membership or its value.

The New York Stock Exchange admits to membership only individuals. This is definitely shown by constitutions and by-laws. Article IX, Sec. 1 of the constitution, states that "to be eligible for election as a member of the Exchange, a person must be at least 21 years of age and a citizen of the United States", etc. This language refers to individuals and not corporations. Sec. 6 provides that no person elected to membership shall be admitted to the privileges thereof until he shall have signed the constitution of the Exchange, and "by such signature, *he* pledges *himself* to abide by the same"—again the language refers to the person and not a corporation. To set aside any doubt on the question, the New York Stock Exchange issued a ruling, referred to in testimony at page 12, providing that

"Membership in the Exchange is a privilege or franchise extended to an *individual*. No other person or persons may jointly acquire any title to this membership in any form or by any means whatsoever."

As hereinabove mentioned, a broker is compensated for the services which he renders to his customers in effecting purchases and sales of securities by commissions. The constitution of the New York Stock Exchange provides:

"ARTICLE XV.

"Commissions and Service Charges.

"SEC. 1. Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for the account of members or allied members or of parties not members or allied members of the Ex-

change, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a rule adopted by the Board of Governors, shall be given, paid, or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member or allied member of the Exchange or member firm.

“Notwithstanding the provisions of this Article, any member of the Exchange or member firm holding a membership or associate membership in another exchange located in the United States, or holding a membership or associate membership in a Canadian exchange, or registered with a Canadian exchange as being entitled to a return of commission from members of said exchange, may in respect of transactions made on such other exchange charge the rates of commission prescribed by such other exchange.”

The above provision is another reason why petitioners cannot incorporate. It is obvious that any corporation engaged in this same business would have to pay a stock exchange member the full commission on any sale or purchase made for a customer of the corporation. Hence, to stay in business a corporation would have to charge the customer something over and above the prescribed rate. As stated by Mr. Rodler, no corporation would stay in business very long if it did business in this manner. He said:

“THE WITNESS: That is possible, but the broker must pay the full commission to the member of the Exchange, and in order to get any income from the transaction he would have to add an extra commission because the competition from the regular members would soon put him out of business. I think.

(T. p. 15)

* * * * *

"A. You would have to buy or sell through a member of one of the Exchanges and pay the full exchange commission.

"Q. Why would you have to pay a full Exchange commission?

"A. The rules of the Exchange provide there shall be no splitting of commissions or any rebates of commissions.

"Q. And if you wanted to get any compensation in dealing through some member of the New York Stock Exchange you would have had to have that full commission, would you not?

"A. Yes.

"Q. What would happen then?

"A. If the customer had any sense he would go to a member."

(T. p. 16-17)

Apropos of the New York Stock Exchange, it has been essential to elaborate on it not only because it is the largest in the country and sets the pattern for all other exchanges but also because petitioners do most of their business with it, and without membership therein they could not stay in business. The testimony of the partners below mentioned is that approximately 85 percent of their business is with the New York Stock Exchange:—(Mr. Rodler, one of the partners, testified).

"Q. Measured in terms of dollar value, with what Exchange do you do the most business?

"A. New York Stock Exchange.

"Q. Are you able to state in percentages how much of your business is done with the New York Stock Exchange?

"A. I would estimate 85 per cent.

THE BOARD: What year?

MR. AIELLO: 1947.

By Mr. Aiello:

"Q. You are speaking of the year 1947?

"A. I am.

"Q. Would you stay in business if you lost the New York Stock Exchange business?

"A. No.

"Q. Why not?

"A. Because the income would not be sufficient to pay the expenses of rent and salaries of running the business."

(T. p. 11)

Mr. Elgin, another partner, testified as follows:

By Mr. Aiello:

"Q. If the commission you received in 1947 from the New York Stock Exchange were taken away from your firm, would it then be able to continue in business from the income derived from other sources?

"A. No.

"Q. Why not?

"A. Because the income from other sources would not cover the expenses of salaries, rents and other incidental expenses, and so forth."

(T. p. 38)

From the standpoint either of the custom of the trade or the rules of the New York Stock and other Exchanges, in which the petitioners hold memberships, or from the financial standpoint, it is clear that petitioners cannot carry on their business through the medium of a corporation. It is submitted, therefore, that petitioners squarely come within the exclusion contained in the statute and regulations of an unincorporated business which by *custom* now sanctioned by judicial decisions and law cannot be incorporated. This is true, notwithstanding the fact that a very small portion of the business of petitioners consists of over-the-counter-marketing, service charges and proxy service fees, which admittedly could be carried on by a corporation. The inhibition against incorporating in so far as this negligible part of their business is concerned lies in the inability of petitioners to exist in business if the same was limited to these small items. This factor is well illustrated by the cross-examination of Mr. Rodler, as follows:

"Q. What was the business of W. B. Hibbs & Company in 1947?

"A. Stockbrokers.

"Q. It was not the business of being a member of the New York Stock Exchange, however, was it?

"A. I say unless we were, we would not have been in business.

"Q. Was your business a membership? Would you have earned one cent by just being a member?

"A. We would not have earned one cent if we had not been a member."

(T. p. 31)

THE BOARD'S DECISION.

The business of petitioners is trading. Trading has been defined as the process of carrying on trade; buying and selling; commercial dealing. The view of the Board of Tax Appeals in regard to the nature of petitioners business is found in the last three paragraphs of its opinion, reading as follows:

"It is in the sense of custom having the force of law that word is used in the statute. This becomes apparent when the context in which the word is used is considered. The statute does not exclude any trade or business which is usually not incorporated, but instead, a business which by custom "cannot" be incorporated. The word "cannot" connotes a prohibition, something more than lack of expediency, departure from the usual.

"It is not likely that a mere regulation or custom of a particular market or a number of markets in regard to the non-eligibility of corporations to trade therein, can be said to amount to a custom within the meaning of the statute, particularly when other markets having no such regulation or custom exist, and new markets without such regulations or custom may lawfully be created at any time.

"The business of a stockbroker can lawfully and properly be conducted by a corporation. The trades and businesses which are excluded from taxability are

those species which cannot be incorporated and not particular firms engaged in those phases thereof which render the corporate method less advisable or less profitable than the individual or partnership method."

Considering the above paragraphs, in the light of the evidence in the case at bar, petitioners respectfully submit:

As to the first of the above paragraphs, a reading and proper appraisal of the history of the stockbrokerage business, as revealed in the case at bar, proves that the custom of limiting membership in stock exchanges to individuals and prohibiting membership therein to corporations stems from an ancient custom of the market place, so much so, that this custom does have the force of law, and has been so recognized by our courts. The position in which petitioners find themselves in such regard cannot be brushed aside by saying that they are in a "business which is usually not incorporated" or saying that petitioners are not prohibited from incorporating their business but do not do so because it is inexpedient. To incorporate meant being put out of business, which is a long cry from "lack of expediency". In order to reach the conclusion it did, the Board also had to say that the word "cannot" connotes a prohibition. The dictionary does not seem to support this connotation. The word "can" is defined as "to have ability"—"be able"—"to possess the qualities, qualifications or resources necessary for the attainment of any end or the accomplishment of any purpose"—(The Century Dictionary and Cyclopedia, Vol. 1, p. 783). The negative of the word logically means not to have the ability or not to be able. Further, prohibit has been defined in one sense "to forbid"—"interdict by authority". To imply that the word "cannot" means to forbid or interdict by authority, as the Board seemingly intends it to mean, gives the provision of the statute a twist that is unnatural and foreign to the ordinary meaning of the word, and it is elemental that words should be given their ordinary and natural meaning when used in a taxing statute.

As to the second paragraph, there is much more involved here than a "mere regulation or custom of a particular market"—to repeat, the custom relied upon by petitioners is steeped in antiquity, and the reason for requiring individual membership is that the customer, in order to get proper protection, looks to the individual for financial responsibility, and to allow corporations to engage in the business is to permit individuals to escape the personal liability involved. In passing it is significant to note that in a nation-wide poll taken of its members this year, the New York Stock Exchange again voted down overwhelmingly a proposal to amend its by-laws to allow corporations to become members.

As to the third paragraph, the conclusion of the Board that "the business of a stockholder can lawfully and properly be conducted by a corporation" is in the teeth of the evidence, and the Findings of the Board itself. The Constitution, By-laws and Regulations of the New York Stock Exchange and other exchanges which are similar to it do not allow corporations as members, and it is not possible to conduct business with these exchanges by or through the medium of a corporation. Moreover, the trade or business here involved is of such nature that it has been universally accepted by those engaged in the same from time immemorial as one which should not and may not be properly undertaken in a corporate capacity. Such trade or business then is entitled to exemption as being within the class prohibited by "customs", which the Supreme Court of the United States has stated "have sprung from the necessities and the convenience of business and prevailed in duration and extent until they acquired the force of law." *Merchants National Bank v. The State National Bank*, 77 U. S. (10 Wall.) 604, 651.

The Board has found that petitioners had seats in the names of some of the partners in the New York Stock Exchange and other exchanges (Finding 4). It also found that "to be able to do business on these exchanges a *person*

must be a member of such exchange" (Finding 5); and it further found that "the New York Stock Exchange has been in existence since 1817. It has *always* denied membership to corporations". Taking these findings together, it requires no elaborate demonstration to pin point the conclusion of the Board as a "non sequitur."

CONCLUSION.

Wherefore, petitioners respectfully submit that the decision of the Board of Tax Appeals for the District of Columbia should be reversed, and a refund ordered of the unincorporated business franchise tax for the year 1947, and the penalty and interest thereon imposed.

CAESAR L. AIELLO,
901 Hibbs Building,
Washington 5 D. C.,
Attorney for Petitioners.

McKENNEY, FLANNERY & CRAIGHILL,
901 Hibbs Building
Washington 5, D. C.
Of Counsel

APPENDIX

INDEX TO APPENDIX.

	Page
Petition	1
Supplemental Petition	9
Decision	11
Findings of Fact	12
Conclusions of Law	16
Memorandum Opinion	16
Petition of Taxpayer for Review.....	19
Excerpts from Testimony	25
James C. Elgin	27
Paul P. Rodler.....	25

APPENDIX.

1

Filed Feb 23 1949

BOARD OF TAX APPEALS FOR THE DISTRICT OF COLUMBIA

Docket No. 1144

DAVID S. HENDRICK, JAMES C. ELGIN, J. CARL PERRY, PAUL P. RODLER, JOHN J. DUNN, and JAMES A. BRUEN, a Partnership, trading as W. B. HIBBS & COMPANY, *Petitioners,*

v.

DISTRICT OF COLUMBIA, *Respondent.*

Petition.

The above-named petitioners hereby petition for a cancellation of an assessment of taxes against them, and allege as follows:

1. The petitioners are a partnership having offices in the Hibbs Building, 723 - 15th Street, N. W., Washington 5, D. C.

2. The tax in controversy is an unincorporated business tax for the calendar year 1947, amounting to \$975.29, plus penalty and interest thereon amounting to \$274.87, making a total of \$1,250.16.

3. There was no notice of assessment sent to the petitioners. Under date of January 7, 1949, petitioners received a form letter from W. C. Thompson of the Income & Franchise Tax Division, Office of the Assessor, stating in effect that the application of the petitioners for renewal of their unincorporated business license for the calendar year 1949 would be held in abeyance and no license would be issued pending a determination of the liability of the petitioners for the District of Columbia unincorporated tax. A true copy of said letter is hereto attached, marked Exhibit A and made a part hereof.

2

Under date of January 26, 1949, petitioners filed involuntarily and under protest in writing an unin-

corporated business franchise tax return for the calendar year 1947, and in connection therewith paid under protest in writing the sum of \$975.29, representing the amount shown to be due on the face of the return. A true copy of petitioners' letter of protest is hereto attached, marked Exhibit B and made a part hereof.

Under date of February 3, 1949, petitioners received from the Assessor, D. C., and paid under protest in writing to the Collector of Taxes, D. C., a bill for penalty and interest assessed on said unincorporated business tax of \$274.87, aforesaid. A true copy of their letter of protest is hereto attached, marked Exhibit C and made a part hereof.

There are attached hereto and made a part hereof receipted bills, marked Exhibits D and E, covering the payment of the unincorporated business tax of \$975.29, and the penalty and interest thereon amounting to \$274.87.

4. The assessment of the tax, and the penalty and interest thereon, set forth above, is based upon the following errors:

(a) The respondent has erred in determining that petitioners, as a partnership, engaged in the brokerage business, are liable for the unincorporated business tax, as provided by Title 8, of the District of Columbia Revenue Act of 1947, approved July 16, 1947 (Pub. Law 195, 80th Cong.).

(b) Respondent has erred in failing to give effect in so far as petitioners are concerned to the definition of an unincorporated business, as provided in Section 1, Title 8, of the said District of Columbia Revenue Act of 1947. It is stated therein that the words "unincorporated business" do not include any trade or business which by law, customs, or ethics cannot be incorporated.

3 (c) The respondent erred in holding that petitioners are not precluded from incorporating in order to carry on their trade or business.

5. The facts upon which the petitioners rely as the basis of this proceeding are as follows:

(a) In the calendar year 1947, petitioners were partners engaged in the stock brokerage business. They filed in due

season a District of Columbia income tax partnership return for the year 1947. During said year, petitioners, trading as W. B. Hibbs & Company, held membership in the (1) New York Stock Exchange, (2) New York Curb Exchange, (3) Chicago Board of Trade and (4) Washington Stock Exchange. Under the rules of the New York Stock Exchange, no member is allowed to incorporate and a seat on said exchange must be individually held. Moreover, under said rules, where the brokerage business is conducted by a firm having more than one person, the persons so interested therein must conduct their business as a partnership. In the circumstances, petitioners were definitely prevented from incorporating in order to carry on their trade and business pursuant to the customs and ethics of the trade and business in which they were engaged.

(b) Petitioners filed an application for renewal of their unincorporated business license for the calendar year 1949. The license was refused by letter dated January 7, 1949, aforesaid, and after petitioners filed an unincorporated business franchise tax return for the year 1947 and paid the tax, penalty and interest under protest in writing, as aforesaid, their license was issued. The filing thereof and the payment of the tax, with penalty and interest therefor, was obtained under conditions amounting to coercion and duress. Petitioners are advised and aver that there is no provision of law justifying this procedure.

4 Wherefore, the petitioners pray that this Board may hear the proceeding and determine that petitioners are not subject to the unincorporated business tax for the reasons aforesaid, and petitioners further pray that the assessment of \$975.29 and the penalty and interest thereon amounting to \$274.87 be set aside, and an order entered refunding the total amount to petitioners.

CAESAR L. AIELLO
Counsel for Petitioners
901 Hibbs Building
Washington 5, D. C.

District of Columbia, ss:

Paul P. Rodler, being duly sworn on oath, deposes and says that he is a partner of the firm of W. B. Hibbs & Company, and as such is authorized to verify the foregoing petition on behalf of the partners of said firm; that he has read the foregoing petition and is familiar with the statements therein contained; and that the statements therein contained are true except those stated to be upon information and belief and those he believes to be true.

PAUL P. RODLER

Subscribed and sworn to before me this 21st day of February, 1949.

ELIZABETH MAYNARD

(Seal)

Notary Public

My Commission Expires Sept. 14, 1953.

5

Exhibit A.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ASSESSOR

Income and Franchise Tax Division
District Building
14th and E Streets, N. W.
Washington 4, D. C.

January 7, 1949

W. B. Hibbs & Co.
725 15th St. N. W.
Washington, D. C.

Gentlemen:

This office is in receipt of your application for renewal of unincorporated business license for the calendar year 1949. Please be advised that the District of Columbia Income and

Franchise Tax Act of 1947 and the Regulations promulgated thereunder provide:

“ * * * No license shall be issued or renewed if the taxpayer has failed or refused to pay any tax or installment thereof, or penalties or interest thereon, imposed by this Article. * * * ”

“Each of the following persons shall file a return with the assessor:

* * *

“Every unincorporated business engaging in or carrying on any business within the District or receiving income from sources within the District within the meaning of title X having a gross income of more than \$10,000, regardless of whether or not it has a net income. * * * ”

“ * * * Every unincorporated business engaging in or carrying on any trade or business within the District and having a gross income for the taxable year of more than \$10,000 * * * must first obtain a license so to do. * * * ”

In view of the fact that you have obtained a license for the past year, this office assumes that your gross income for the taxable period preceding such year exceeded \$10,000; however, our records indicate that the return for that period has not been filed. As it appears that you have
6 failed to comply with the law in this respect, it is impossible for this office to determine whether there is any tax due the District of Columbia. As we have no return from you and no word as to whether your gross income is less than \$10,000, this office has no alternative except to refuse to issue the license at this time.

Title XIV, Sec. 7 of the Act also provides:

“Any corporation or unincorporated business engaged in or carrying on any trade or business in the District or receiving income from sources within the District * * * without having obtained a license so to do, * * * and any per-

son engaging in or carrying on trade or business in the District or receiving income from sources within the District * * * for or on behalf of any corporation or unincorporated business not having a license so to do, shall, upon conviction thereof, be fined not more than \$300 for each and every failure, refusal, or violation, and each and every day that such failure, refusal or violation continues shall constitute a separate and distinct offense. * * *"

We are holding your check and application pending your further advice in this matter.

Yours very truly,

/s/ W. C. THOMPSON
Income & Franchise Tax
Division

7

Exhibit B.

January 26, 1949

Assessor of Taxes, D. C.
District Building
Washington, D. C.

Dear Sir:

Herewith, we hand you involuntarily our unincorporated business franchise tax return for the calendar year 1947, together with our check, payable to the order of the Collector of Taxes, D. C., in the sum of \$975.29, representing the amount of tax payable on the face of the return.

This return is being filed and the tax is being paid under protest, reserving the right on our part to claim and obtain a refund thereof. Upon advice of counsel, we believe that our firm is not subject to the District of Columbia Unincorporated Business Franchise Tax, and not required to file any return in connection therewith. It is proposed to litigate the applicability of the tax to our firm, and the reason the return is being filed now is that we have been refused a license to do business for the current year because of the alleged failure on our part to file an unincorporated busi-

ness franchise tax return. It is our contention that the failure on the part of the District of Columbia to grant the license unless and until such a return is filed is improper and unlawful.

Very truly yours,

8

Exhibit C.

February 3, 1949

Collector of Taxes, D. C.
District Building
Washington, D. C.

Gentlemen:

Herewith we hand you our check payable to your order in the sum of \$274.87 in payment of the attached bill covering penalty and interest assessed on an unincorporated business tax of \$975.29, which was paid to you on January 26, 1949, with a covering letter of protest. The payment being made herewith is tendered to you under the same terms and conditions of protest as set forth in our letter of January 26, 1949. Please note on the tax bill that it is being paid under protest.

Very truly yours,

JCE:mh

9

Exhibit D.

DISTRICT OF COLUMBIA

Form D-30

Ledger No.

Indicate below amount of payment submitted with this return.

\$975.29

Collector's Stamp, Jan-26-49 212 —Chk—P 975.29

Paid—Guy W. Pearson, Collector of Taxes, D. C.

1948

Franchise Tax

1948

Government of the District of Columbia

This receipt not valid unless collector's stamp appears hereon.

Trade Name W. B. Hibbs and Company
 Address 725 15th St. N. W., Washington, D. C. Zone
 No. 5.

Make check payable to Collector of Taxes, D. C.
 Paid under protest.

Do not detach

Exhibit E.

1947—FRANCHISE TAX—1947
 Government of the District of Columbia
 Office of the Assessor, D. C.
 Credit 1948 Levy

First Half
 Second Half
 Both Halves x
 Unpaid Balance x
 Deficiency

Date of Assessment February 2, 1949

Name, W. B. Hibbs and Co., 725 15th St. N. W., City 5;
 Total Tax, 975.29, *243.82, **31.05. * 25% late filing pen-
 alty. **Int. @ 6% per annum on both halves to 1/26/49.
 Previous Credit, 975.29; Date,
 Payment Due, 274.87.
 8F-948

Interest on payment due at the rate of 6% per annum
 must be added if not paid on or before February 12, 1949.

Send remittance with both copies of this notice to the
 Collector of Taxes, D. C., payable to his order. If receipt
 is desired, enclose stamped self addressed envelope.

Interest at rate of 6% per annum from
 to Total Payment Due
 Credit: 9019 Unincorporated Business Tax

* * * * *

Filed July 19, 1949

Supplemental Petition.

The supplemental petition of the above-named petitioners respectfully represents as follows:

1. Under date of July 12, 1949, petitioners filed with the Assessor of Taxes, D. C., a claim for refund of the unincorporated business franchise tax and penalty and interest thereon, amounting to \$1,250.16, which was paid under protest in writing for the calendar year 1947.

2. Under date of July 13, 1949, the above-mentioned claim for refund was denied, as per copy of letter from M. J. Kissinger, Chief Examiner, Income and Franchise Tax Division, hereto attached and made a part hereof.

3. Petitioners, being advised that the jurisdiction of this Board is open to question under the original petition, respectfully request that the said original petition be considered as amended and treated, among other things, as an appeal from a denial for claim for refund, in order that the controversy involved herein may be disposed of on the merits.

CAESAR L. AIELLO

Attorney for Petitioners,

901 Hibbs Building,
Washington 5, D. C.

DISTRICT OF COLUMBIA, ss:

PAUL P. RODLER, being duly sworn on oath, deposes and says that he is a partner of the firm of W. B. Hibbs & Company, and as such is authorized to verify the foregoing supplemental petition on behalf of the partners of said firm; that he has read the foregoing supplemental petition and is familiar with the statements therein contained; and that the statements therein contained are true, except those

stated to be upon information and belief, and those he believes to be true.

PAUL P. RODLER

Subscribed and sworn to before me this 19th day of July 1949.

ELIZABETH MAYNARD

Notary Public, D. C.

My commission expires Sept. 14, 1953.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ASSESSOR

Income and Franchise Tax Division
District Building
14th and E Streets, N. W.
Washington 4, D. C.

REGISTERED LETTER

RETURN RECEIPT REQUESTED

July 13, 1949

Mr. Caesar L. Aiello,
McKenney, Flannery & Craighill,
Hibbs Building,
Washington 5, D. C.

Dear Mr. Aiello:

Receipt is acknowledged of your letter of July 12, 1949 together with claim for refund of the unincorporated business tax paid by W. B. Hibbs & Company for the calendar year 1947.

Please be advised that this office has carefully considered the information submitted and is of the opinion that your client is not exempt from the provisions of the District of Columbia Income and Franchise Tax Act of 1947 for the filing of returns, payment of the taxes, and obtaining the

necessary licenses. The claim for refund is, therefore, denied.

Very truly yours,

M. J. KISSINGER,
*Chief Examiner, Income and
Franchise Tax Division*

* * * * *

18

Filed Jul 27 1949

Decision.

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof and of the evidence adduced at the hearing on said petition, it is, by the Board, this 27th day of July, 1949,

Adjudged and Determined, That the action of the Assessor in denying claim for refund of unincorporated business franchise tax for 1947, herein appealed from, be, and it is hereby, affirmed.

LAWRENCE KOENIGSBERGER,
*Member Sole, Board of Tax
Appeals for the District of Co-
lumbia*

Findings of Fact and Conclusions of Law, Memorandum and Decision served as follows:

Caesar L. Aiello, Esq.,
901 Hibbs Building,
Washington 5, D. C. (Mailed 7/27/49)
Assessor, D. C. (Personally 7/27/49)
Corporation Counsel, D. C. (Personally 7/27/49)

MILDRED R. JONES
Acting Clerk

* * * * *

Filed Jul 27 1949

Appeal from the action of the Assessor in denying claim for refund of unincorporated business franchise tax for 1947.

Findings of Fact and Conclusions of Law.

FINDINGS OF FACT.

1. Petitioners, David S. Hendrick, James C. Elgin, J. Carl Perry, Paul P. Rodler, John J. Dunn, and James A. Bruen, compose a partnership trading as W. B. Hibbs & Company. The partnership was formed July 1, 1947. It is the successor of a partnership of similar name formed in 1944. The articles of partnership of both firms are identical, except as to the names of the partners and the provisions as to the apportionment of profits and losses. The petitioners John J. Dunn and James A. Bruen, were not members of the former partnership.

2. By the articles of partnership it was agreed that the business of the partnership shall be to buy, sell, and deal in stocks, bonds, grain and other securities and commodities, and to carry on a general brokerage, stock exchange and commission business.

3. In 1947 the activities of the firm consisted of buying and selling stocks, bonds and securities as brokers, on the New York Stock Exchange, the New York Curb Exchange and over the counter, and in the buying and selling of grain on the Chicago Board of Trade. There was also a small item called "commission locals", the nature of which
11 was not revealed.

In addition the firm derived income from interest, and there were other minor sources of income.

4. Petitioner Hendrick is a member of the New York Stock Exchange, the New York Curb Exchange, the Washington Stock Exchange and the Chicago Board of Trade; petitioners Elgin and Rodler are members of the Washington Stock Exchange. The partnership is not a member of

any of these exchanges, but as between the petitioners and the partnership, these memberships are assets of the partnership.

5. To be able to do business on these exchanges a person must be a member of such exchange. No such membership is required for acting as broker in "over the counter" transactions. An over the counter transaction by a broker as such, consists of buying securities from the owner or selling to the purchaser, not through a stock exchange, for the account of a principal, and charging the principal a commission on such purchase or sale.

6. Petitioners have not acted as principals in purchase and sale of securities.

7. During 1947 the gross income of petitioners was \$234,528 composed as follows:

Commissions on New York Stock Exchange	64%
Commissions on New York Curb Exchange	6%
Commissions on over the counter transactions	7%
Commissions on grain transactions	2%
Interest on margin accounts	20%
Miscellaneous	1%

The interest item was to a great extent based on money owing to petitioners on margin accounts on securities which the firm had bought on the New York Stock Exchange. It does not appear from the evidence that membership in the New York Stock Exchange was necessary to enable petitioners to carry margin accounts on stocks listed on that exchange.

12 8. Petitioners' total commissions during 1947 were \$185,491 composed as follows:

On New York Stock Exchange	82%
On New York Curb Exchange	7%
Over the counter	9%
Grain	2%

9. Petitioners' total expenses during 1947 were \$152,434. These expenses were not allocated among petitioners' various activities.

10. The New York Stock Exchange has been in existence since 1817. It has always denied membership to corporations.

11. The Rules of the Board of Governors of the New York Stock Exchange provide, that whenever it appears that a member or a member firm or partner thereof has such business connection with a corporation that the corporation dominates the policy of such business, the Board of Governors may require a discontinuance of such business connection; that, without the consent of the Exchange, no member or member firm can act as a broker for any corporation if such corporation is controlled by such member or firm or by a partner of such firm, and is itself engaged in the business of buying and selling securities as a broker; that if a member or his firm or partner of a member is an officer, director, employee, or stockholder of a corporation engaged in the business of buying and selling securities for its own account or as broker, such member shall not participate in any commission paid by such corporation unless either such member or his firm is engaged in the general brokerage business and as such actively participates in the transaction on such commission is paid; and, that without the consent of the Exchange, no member or member firm shall permit any corporation engaged in the business of buying and selling securities for its own account or as broker, to use as its office the office of such member or firm, or to employ in its business the same business organization

13 as that employed by such member or firm, or permit any such corporation to conduct its business under a name that does not thoroughly differentiate such corporation from such member or firm. The Rules further provide that if a member or member firm or partner thereof controls a corporation engaged in the business of buying and selling securities for its own account or a broker, such

member or firm shall be responsible for any fraud committed by such corporation.

12. It is contrary to the Rules of the New York Stock Exchange for members thereof to charge less than the commissions prescribed by that Exchange, or to allow any rebate, return, discount or allowance; consequently, a person who is not a member of the Exchange, or a firm not affiliated with the Exchange through one of its members who is a member of the Exchange, would not make any money on transactions through the New York Stock Exchange, except by making a charge to its customers in addition to the usual brokerage. This would put it in an unfavorable competitive position compared to other brokers one or more of whose members were members of the Exchange, and such firm would probably not be able to obtain any substantial amount of such business.

13. On December 20, 1948, petitioners applied to the Assessor for an unincorporated business license for 1949. The Assessor refused to issue such license, because petitioners had not filed an unincorporated business franchise tax return for 1947. Petitioners thereupon, on January 26, 1949, filed such return and paid the tax thereby shown to be due, namely \$975.29. On February 3, 1949, they paid \$274.87, covering interest and penalty, a total of \$1,250.16. These payments were made under protest.

14. On February 23, 1949, petitioners filed their appeal herein, upon the ground that they were not liable for the unincorporated business tax, by reason of the fact that they were engaged in a trade or business which by law, custom, or ethics cannot be incorporated.

14 15. On July 12, 1949, petitioners filed with the Assessor a claim for refund of said tax, interest and penalty. On July 13, 1949, the claim was denied by the Assessor. On July 19, 1949, petitioners filed herein their supplemental petition in which they recited the filing of their claim for refund, and the denial thereof.

CONCLUSIONS OF LAW.

1. The business of a stockbroker, in which petitioners were engaged during the year 1947, was not a trade or business which by law, customs or ethics cannot be incorporated, within the meaning of Article 1, Title VIII, section 1 of the District of Columbia Income and Franchise Tax Act of 1947 (D. C. Code 1940, Supp. VI, sec. 47-1574).

2. Petitioners' claim for refund was properly denied, and the action of the Assessor in denying the claim should be affirmed.

Decision will be entered for Respondent.

LAWRENCE KOENIGSBERGER,
Member Sole,
 Board of Tax Appeals for
 the District of Columbia.

* * * * *

15

Filed Jul 27 1949

Memorandum.

The question on this appeal is whether the petitioners, co-partners composing a firm of stockbrokers, are liable for the unincorporated business franchise tax imposed by Article I, Title VIII, section 3, of the District of Columbia Revenue Act of 1947 (D. C. Code 1940, Supp. VI, sec. 47-1574b).

Petitioners claim that they are not subject to the tax, by reason of section I of the Title referred to (D. C. Code 1940, Supp. VI, sec. 47-1574), which provides that the unincorporated businesses upon which the tax is levied, do not include "any trade or business which by law, customs or ethics cannot be incorporated", and the particular exclusion on which they rely is that based on "customs".

During 1947, the year here involved, petitioners' gross income was derived from commissions as stockbrokers and grain brokers, also from interest on margin accounts, and, to a very small extent, from various miscellaneous activi-

ties. One of the petitioners was a member of the New York Stock Exchange, and the firm, by reason of such membership and through that member, was able to, and did buy and sell on that exchange, securities listed thereon.

16 During the year, the commissions earned by petitioners on the New York Stock Exchange were 82% of all of the firm's commissions, and were 64% of its entire income from all sources.

Membership on the New York Stock Exchange has always, during the entire existence of that body, been restricted to natural persons. This has been true also of most, but not all stock exchanges in the United States.

As a result of the practice of the New York Stock Exchange—an unofficial body—a corporation may not be a member of that exchange. However, the business of a stock broker can be conducted by corporations on exchanges which do admit corporations to membership, and stockbrokers can, and petitioners did, also derive income from transactions over the counter, which do not require membership in any stock exchange. Interest on margin accounts, although in the case of petitioners resulting to a great extent from its activities on the New York Stock Exchange, can also be independent of such trading.

The word "custom" is sometimes used in the sense of habitual or usual; but in another sense, and the sense which seems to have been that in which it was used in the statute here under consideration, it means more than that, namely, a custom which has acquired the force of law. *Etna Forge & Bolt Co. v. Youngstown Sheet and Tube Co.*, 282 F. 786, 789; *Argos Kid Co. v. Blumenthal*, 282 Mass. 1, 184 N. E. 279; *Maeder Steel Products Co. v. Zanello*, 109 Or. 562, 220 P. 155; *Creitz v. Bennett*, 350 Ill. 32, 182 N. E. 736; *City Dairy Co. v. Usero*, 101 Ind. App. 375, 199 N. E. 456. As is well known, the common law is based on custom and has the same force as statutory law. The law merchant is an example of custom which has acquired the force of law. Likewise, the prohibition of the practice of law by

17 corporations is based on custom which has acquired the force of law, *Merrick v. American Security & Trust Co.*, 71 App. D. C. 72, 107 F. (2d) 271, citing notes in 73 A. L. R. 1327 and 105 A. L. R. 1364.

It is in the sense of custom having the force of law that word is used in the statute. This becomes apparent when the context in which the word is used is considered. The statute does not exclude any trade or business which is usually not incorporated, but instead, a business which by custom "cannot" be incorporated. The word "cannot" connotes a prohibition, something more than lack of expediency, departure from the usual.

It is not likely that a mere regulation or custom of a particular market or a number of markets in regard to the non-eligibility of corporations to trade therein, can be said to amount to a custom within the meaning of the statute, particularly when other markets having no such regulation or custom exist, and new markets without such regulations or custom may lawfully be created at any time.

The business of a stockbroker can lawfully and properly be conducted by a corporation. The trades and businesses which are excluded from taxability are those species which cannot be incorporated and not particular firms engaged in those phases thereof which render the corporate method less advisable or less profitable than the individual or partnership method.

The action of the Assessor in denying petitioners' claim for refund was correct and it will be affirmed.

LAWRENCE KOENIGSBERGER,

Member Sole,

Board of Tax Appeals for
the District of Columbia.

* * * * *

Filed Aug 23 1949

Petition of Taxpayers for Review by the United States Court of Appeals for the District of Columbia of a Decision by the Board of Tax Appeals for the District of Columbia.

Taxpayers, the petitioners in this cause, by Caesar L. Aiello, counsel, hereby file their petition for a review by the United States Court of Appeals for the District of Columbia of the decision of the Board of Tax Appeals for the District of Columbia, rendered July 27, 1949, determining that an unincorporated business franchise tax for 1947 amounting to \$975.29, and interest and penalty thereon of \$274.87, a total of \$1,250.16, were lawfully assessed against petitioners by the Assessor of the District of Columbia and collected from them by the Collector of Taxes of the District of Columbia.

I.

Petitioners, David S. Hendrick, James C. Elgin, J. Carl Perry, Paul P. Rodler, John J. Dunn and James A. Bruen, are partners, trading under the name of W. B. Hibbs & Company. The partnership was formed on July 1, 1947. It is the successor of a partnership of similar name formed in 1944. The articles of both firms are identical, except as to the names of the partners and the provisions as to the apportionment of profits and losses. The petitioners,
20 John J. Dunn and James A. Bruen, were not members of the former partnership. Petitioners all are citizens of the United States, and the firm has its offices in the Hibbs Building, 723 - 15th Street, N. W., in Washington, D. C.

II.

NATURE OF THE CONTROVERSY.

(a) The controversy involves the question of the liability of petitioners for the District of Columbia unincorporated

business franchise tax and the validity of the assessment and collection by the Assessing and Collecting authorities of the District of Columbia of an unincorporated business franchise tax, with interest and penalties, for the calendar year 1947.

(b) Petitioners, by their articles of partnership, agreed to engage in the business of buying, selling and dealing in stocks, bonds, grain and other securities and commodities, and to carry on a general brokerage, stock exchange and commission business. More specifically, in 1947 the business of the firm consisted of executing orders on the New York Stock Exchange, New York Curb Exchange, Washington Stock Exchange, Chicago Board of Trade, and acting as brokers for customers. In order to do business on these exchanges, the firm was required to have a membership therein, colloquially called "a seat", and during the taxable year involved, petitioner, David S. Hendrick was a member of the New York Stock Exchange, New York Curb Exchange, Washington Stock Exchange and the Chicago Board of Trade; petitioners, James C. Elgin and Paul P. Rodler were members of the Washington Stock Exchange. These memberships or seats were required to be held in the names of individuals but were treated as assets of the partnership.

The seat on the New York Stock Exchange has been held by the firm since 1895 and the seats on the other
 21 exchanges, as aforesaid, have been held by the firm for over thirty years. It is customary and essential for a stock brokerage business similar to petitioners to be conducted under a partnership arrangement, and the rules of the New York Stock Exchange requires this form of set-up.

The Constitution of the New York Stock Exchange provides that it was formed for the following purpose:-

"The title of this Association shall be the New York Stock Exchange.

"Its objects shall be to furnish exchange rooms and other facilities for the convenient transaction of their business by its members; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade and business."

Article 9 thereof provides that in order to be eligible for membership a person must be at least 21 years of age and a citizen of the United States. No person may be elected to membership without signing the constitution of the Exchange, by which he pledges himself to abide by the same. There is no provision therein for the admission to membership on the Exchange by the corporations as such. The members of petitioners' firm holding seats have signed the constitution of the exchanges involved, and are bound by the provisions thereof.

The limitation for membership on the New York Stock Exchange to individuals is based on the principle of personal liability of each individual and of each partner in the firm. By a ruling of the New York Stock Exchange, it is provided that "Membership in the exchange is a privilege or franchise extended only to an individual. No other person or persons may jointly acquire any title to his membership in any form or by any means whatsoever." The constitution and by-laws of the other exchanges, of which the partners are members, do not materially differ from the

requirements of the Constitution and By-laws of the
 22 New York Stock Exchange in such respect, and a survey indicates that most all stock exchanges do not permit corporations to be members.

In the taxable year 1947, approximately 85 percent of the business handled by the petitioners was done with the New York Stock Exchange. Two of the partners who appeared as witnesses definitely stated that the firm would not be able to stay in business if it lost the New York Stock Exchange business, and such business definitely would be lost if petitioners incorporated.

In the execution of orders for the purchase or sale of securities or commodities, the relationship between petitioners, as brokers, and their customers, was that of agent only. In no case did they act as principals.

Petitioners did not do any "underwriting", that is, buy securities from a corporation and sell the same to the general public.

It is not, and has not been, the custom of stockbrokers to incorporate. There are approximately 35 active members in the Washington Stock Exchange, and only four or five of them are incorporated. Those that are incorporated conduct a business different from the strictly stockbrokerage business carried on by petitioners.

The New York Stock Exchange has been in existence since 1817. It always has denied membership to corporations.

Petitioners filed a District of Columbia partnership income tax return for the year 1947. On December 20, 1948, they filed an application for a District of Columbia business license, which was refused because the petitioners had not filed an unincorporated business tax return. On advice of counsel, petitioners filed an unincorporated business tax return for the year 1947, whereupon they received a license to do business and the unincorporated business tax, 23 amounting to \$975.29, and penalty and interest thereon amounting to \$274.87, was paid under protest in writing.

III.

Petitioners being aggrieved by the Findings of Fact and Conclusions of Law contained in said findings and opinion of the Board of Tax Appeals, and by its decision entered in pursuance thereto desires to obtain a review thereof by the United States Court of Appeals for the District of Columbia.

CAESAR L. AIELLO,
Counsel for Petitioners,
901 Hibbs Building,
Washington 5, D. C.

DISTRICT OF COLUMBIA, ss:

Caesar L. Aiello, being duly sworn, says that he is counsel of record in the above cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein; and that the statements made are true to the best of his knowledge, information and belief.

CAESAR L. AIELLO.

SUBSCRIBED and sworn to before me this 23rd day of August, 1949.

ELIZABETH F. LEONARD,
Notary Public, D. C.

[SEAL]

* * * * *

Excerpts from Testimony.

Paul P. Rodler:

By Mr. Aiello:

35 Q. Measured in terms of dollar value, with what Exchange do you do the most business? A. New York Stock Exchange.

Q. Are you able to state in percentages how much of your business is done with the New York Stock Exchange?

A. I would estimate 85 per cent.

The Board: What year?

Mr. Aiello: 1947.

By Mr. Aiello:

Q. You are speaking of the year 1947? A. I am.

Q. Would you stay in business if you lost the New York Stock Exchange business? A. No.

Q. Why not? A. Because the income would not be sufficient to pay the expenses of rent and salaries of running the business.

* * * * *

39 The Board: Does he take orders from customers and execute them through a member?

The Witness: That is possible, but the broker must pay the full commission to the member of the Exchange, and in order to get any income from the transaction he would have to add an extra commission because the competition from the regular members would soon put him out of business, I think.

Mr. Aiello: I have some questions along that line that are coming up.

By Mr. Aiello:

40 Q. How is your income derived, Mr. Rodler? A. Mostly from commissions and partly from interest on securities that we buy on the New York Exchange and carry on margin.

Q. In other words, the purchaser pays you interest on the deferred balance? A. Yes, sir.

Q. Is it true that in order to get a commission you must hold a seat on the Exchange? A. That is true.

Q. And if you had no seat how would you go about buying and selling securities? A. You would have to sell through a member of the Exchange.

The Board: He has gone into that.

Mr. Aiello: He has gone into it partly, but I want to bring it out clearly just why we would be in difficulty when we try to incorporate through a third party who has a seat.

By Mr. Aiello:

Q. Will you answer the question? A. You would have to buy or sell through a member of one of the Exchanges and pay the full exchange commission.

Q. Why would you have to pay a full Exchange commission? A. The rules of the Exchange provide there shall be no splitting of commissions or any rebates of commissions.

Q. And if you wanted to get any compensation in dealing through some member of the New York Stock Exchange you would have had to get more than the full commission, would you not? A. Yes.

Q. What would happen then? A. If the customer had any sense he would go to a member.

* * * * *

55 By Mr. Walker:

Q. What was the business of W. B. Hibbs & Co. in 1947? A. Stockbrokers.

Q. It was not the business of being a member of the New York Stock Exchange, however, was it? A. I say unless we were, we would not have been in business.

Q. Was your business a membership? Would you have earned one cent by just being a member? A. We would not have earned one cent if we had not been a member.

Q. Would you have earned anything by the mere fact of your membership in the New York Stock Exchange?

The Board: Of course he would not have earned anything.

* * * * *

62 **James C. Elgin:**

By Mr. Aiello:

Q. If the commission you received in 1947 from the New York Stock Exchange were taken away from your firm, would it then be able to continue in business from the income derived from other sources? A. No.

Q. Why not? A. Because the income from other sources would not cover the expenses of salaries, rents and other incidental expenses, and so forth.

* * * * *

78 Mr. Aiello: Now, may it please the Board, I have an extract here from the same book, entitled "An excerpt from the work of the Stock Exchange, by Meeker" which lays down the rules, general rules, with respect to all stock exchanges, including the New York Stock Exchange, the London Stock Exchange, and the rule states, universally, that stock corporations are always denied membership.

I would like to leave that with you for purposes of reference. I expect to use it in any argument that I might make.

The Board: I would like some evidence as to the Meeker book. How standard a work is it?

Mr. Aiello: All I can do in that respect is to ask Mr. Rodler to testify.

The Board: I never heard of the book.

Mr. Aiello: May I ask Mr. Rodler some questions about it?

The Board: Yes, sir.

Mr. Aiello: Mr. Elgin, you are excused, and we thank you.

(Witness excused.)

* * * * *

Paul P. Rodler:

Mr. Aiello: The issue is under the statute, 80 whether by custom stock brokers are allowed to incorporate, and I am showing by custom, and he gives the custom, and he tells you what it has been since time immemorial.

Mr. Walker. I object.

The Board: I will overrule the objection.

By Mr. Aiello:

Q. Will you give the answer? A. We thought enough of the book to use it as a textbook to lecture our employees during the period of the 1920's to 1932 or 1933.

Q. You say you used it as a textbook? A. Yes.

Q. Have you had occasion to lecture outside of your office? A. No, it was confined to our employees.

Q. How did the book come to your knowledge and attention? A. It was recommended by the Publicity Committee of the New York Stock Exchange to us.

Q. Have you had occasion to use it from time to time?

A. That is correct.

81 Q. Do you know whether or not it is generally acceptable to others. A. It is.

BRIEF, APPENDIX, AND SUPPLEMENT TO BRIEF,
FOR RESPONDENT

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT *United States Court of Appeals*
For the
District of Columbia Circuit

No. 10447

FILED MAR 14 1959

DAVID S. HENDRICK, ET AL, *Petitioners,*

Clerk

v.

DISTRICT OF COLUMBIA, *Respondent.*

ON PETITION FOR REVIEW OF DECISION OF THE BOARD OF TAX
APPEALS FOR THE DISTRICT OF COLUMBIA

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INDEX

SUBJECT INDEX

	PAGE
Supplement to Petitioners' Statement of the Case	1
Statutes Involved	2
Summary of Argument	2
Argument	3
Conclusion	9
Appendix	11
Excerpts from Testimony	11
Supplement to Brief	13
Excerpts from "Business Week"	13
Excerpts from CCH Federal Securities Law Reporter	16

CASES CITED

<i>Agoos Kid Co. v. Blumenthal</i> , 282 Mass. 1, 184 N. E. 279	6
<i>City Dairy Co. v. Usero</i> , 101 Ind. App. 375, 199 N. E. 457	6
<i>Creitz v. Bennett</i> , 350 Ill. 32, 182 N. E. 736	6
<i>Esmar v. Haeussler</i> , 115 S. W. 2d 54	7
<i>Etna Forge & Bolt Co. v. Youngstown Sheet & Tube Co.</i> , 282 F. 786....	6
<i>In re Kentucky Wagon Mfg. Co.</i> , 3 F. Supp. 958, aff'd 71 F. 2d 802. cert. den. sub. nom. <i>Laurent v. Stites</i> , 293 U. S. 612, 79 L. Ed. 701, 55 S. Ct. 142	7
<i>Maeder Steel Products Co. v. Zanello</i> , 109 Or. 562, 220 P. 155	6
<i>Merrick v. American Security & Trust Co.</i> , 71 App. D. C. 72, 107 F. 2d 271, cert. den. 308 U. S. 625, 84 L. Ed. 521, 60 S. Ct. 380	7
<i>Silver v. Lansburgh & Bro.</i> , 72 App. D. C. 77, 111 F. 2d 518	7
<i>Strother v. Lucas</i> , 37 U. S. (12 Peters) 410, 9 L. Ed. 1137	6

OTHER AUTHORITIES

12 C. J. S., Brokers, Sec. 1, p. 7	7
19 C. J. S., Corporation, Sec. 956b, p. 404	7
General Rules and Regulations of the Securities and Exchange Com- mission, Rule X-17A-5	8

STATUTES CITED

District of Columbia Income and Franchise Tax Act of 1947: Title I, Sec. 4(h) (61 Stat. 328. 332, ch. 258), as amended by Public Law 509, 80th Cong., 2d Session, approved May 3, 1948 (62 Stat. ...) 2, 4	
--	--

Title VII -----	3
Title VIII, Sec. 1 -----	2, 4
Securities Exchange Act of 1934, Sec. 3 (48 Stat. 881, 882, ch. 404) ----	8
D. C. Code (1940 ed.):	
Sec. 2-301 -----	6
Sec. 2-701 -----	6
Sec. 2-904 -----	6

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 10447

DAVID S. HENDRICK, ET AL, *Petitioners,*

v.

DISTRICT OF COLUMBIA, *Respondent.*

ON PETITION FOR REVIEW OF DECISION OF THE BOARD OF TAX
APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR RESPONDENT

**SUPPLEMENT TO PETITIONERS' STATEMENT
OF THE CASE**

With the following exceptions the statement of the case contained in petitioners' brief is almost verbatim the same as the findings of fact of the Board of Tax Appeals for the District of Columbia (hereinafter referred to as the "Board"):

In addition to the resumé of the activities of petitioners in 1947 contained on page 2 of their brief, the Board found that:

"There was also a small item called 'commission locals', the nature of which was not revealed" and "In addition the

firm derived income from interest, and there were other minor sources of income" (App. 12);

" * * * It does not appear from the evidence that membership in the New York Stock Exchange was necessary to enable petitioners to carry margin accounts on stocks listed on that exchange" (App. 13).

STATUTES INVOLVED

In addition to the section of the District of Columbia Income and Franchise Tax Act of 1947 set forth on pages 5 and 6 of petitioners' brief, Sec. 4(h) of Title I of said Act, as amended (61 Stat. 328, 332, ch. 258),¹ is also pertinent. Said Sec. 4(h), as amended, provides, insofar as here pertinent, that:

"The words 'trade or business' include the engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia; and include the performance of the functions of a public office.
* * *"

SUMMARY OF ARGUMENT

Under the statute involved, the test for exemption is whether or not the trade or business of the taxpayer is one prohibited by law, customs, or ethics from being engaged in or carried on by a corporation. It is not a question of whether a taxpayer engaging in a particular trade or business would be ineligible, if incorporated, for membership in any stock exchange, trade association, or other voluntary association.

It is clear that stock brokerage is not such a trade or business as is prohibited from being conducted in a corporate capacity.

There are stock exchanges and grain markets other than the New York Stock Exchange which extend the privilege of membership and trading thereon to corporations.

¹ The section was amended by Public Law 509, 80th Congress, 2d Session, approved May 3, 1948, effective with respect to taxable years or parts thereof beginning on January 1, 1948 (62 Stat. --).

Those professions which by law, customs, or ethics cannot be engaged in by corporations are those learned professions wherein is created a personal relationship which cannot exist between the person employing the professional services and a profit-seeking corporation.

ARGUMENT

The first rule of statutory construction is that if the language of the statute is clear there is nothing to construe. Here the statute is clear. The statute under consideration taxes every "unincorporated business", and the words "unincorporated business" are said to mean any trade or business conducted or engaged in by, *inter alia*, a partnership. The words are declared in the statute to include any trade or business which if conducted or engaged in by a corporation would be subject to the tax imposed upon corporations under Title VII of the Act. The only question, then, is whether the business of stockbrokerage may be engaged in or carried on by a corporation. Phrased otherwise, the question is whether a corporation is prohibited by "law, customs, or ethics" from carrying on or engaging in the trade or business of stockbrokerage.

The Board found that:

"By the articles of partnership it was agreed that the business of the partnership shall be to buy, sell, and deal in stocks, bonds, grain and other securities and commodities, and to carry on a general brokerage, stock exchange and commission business.

"In 1947 the activities of the firm consisted of buying and selling stocks, bonds and securities as brokers, on the New York Stock Exchange, the New York Curb Exchange and over the counter, and in the buying and selling of grain on the Chicago Board of Trade. There was also a small item called 'commission locals', the nature of which was not revealed.

“In addition the firm derived income from interest, and there were other minor sources of income.” (App. 12.)

The Board also found:

“To be able to do business on these exchanges a person must be a member of such exchange. No such membership is required for acting as broker in ‘over the counter’ transactions. An over the counter transaction by a broker as such, consists of buying securities from the owner or selling to the purchaser, not through a stock exchange, for the account of a principal, and charging the principal a commission on such purchase or sale.” (App. 13.)

From the fact that a large part of petitioners’ income was derived from commissions on purchases and sales made on the New York Stock Exchange (a voluntary association which has always denied membership to corporations), they contend that they are engaged in a trade or business which may not be conducted by corporations, necessarily upon the theory that the trade or business of stockbrokerage is prohibited by “law, customs, or ethics” from being conducted in a corporate capacity. Under Sec. 4(h) of Title I of the District of Columbia Income and Franchise Tax Act of 1947, the words “trade or business” are defined, insofar as here pertinent, to include “the engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia”, *supra*, p. 2. Substituting the statutory definition of the words “trade or business” for those words in Sec. 1, Title VIII of the Act (Pet. Br., 5, 6), that section reads as follows:

Sec. 1. Definition of Unincorporated Business.—
For the purposes of this article (not alone of this

title) and unless otherwise required by the context, the words "unincorporated business" mean the engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia, conducted or engaged in by any * * * partnership, or limited or special partnership, * * *, other than a trade or business conducted or engaged in by any corporation; and include any trade or business which if conducted or engaged in by a corporation would be taxable under title VII of this Act. The words "unincorporated business" do not include any trade, business, profession, vocation or calling or commercial activity in the District of Columbia which by law, customs, or ethics cannot be incorporated * * *.

While the New York Stock Exchange, a voluntary association, has never admitted corporations to membership, there is nothing of which we are aware which prevents it from doing so. Furthermore, the business of a stockbroker can be conducted by corporations on exchanges which do admit corporations to membership, and stockbrokers can, and petitioners did, also derive income from transactions over the counter, which do not require membership in any stock exchange. Petitioners also received some miscellaneous income, and interest on margin accounts. Petitioners' income in the form of interest on margin accounts results to a great extent from its activities on the New York Stock Exchange, but interest on margin accounts can be obtained independently of such trading (App. 17).

At various points in their brief, petitioners mention that the business of stockbrokerage is prohibited by "law, customs, or ethics" from being carried on by corporations. However, their real contention is not so broad. The basic contention of petitioners is contained in paragraph numbered 1 of their statement of points, viz., that they, as partners, engaged in the stockbrokerage business, could

not, by custom of the trade, incorporate, and were required by the rules of the New York Stock Exchange and other exchanges of which they were members to carry on their business as a partnership (Pet. Br., 7).

The word "custom" is sometimes used in the sense of habitual or usual; but in another sense, and the sense in which it is used in the statute involved, it means that a particular practice or established mode of conduct has been in existence so long and been so universally accepted by all that it has acquired the force of law. *Strother v. Lucas*, 37 U. S. (12 Peters) 410, 9 L. Ed. 1137, 1147; *Etna Forge & Bolt Co. v. Youngstown Sheet & Tube Co.*, 282 F. 786, 789; *Agoos Kid Co. v. Blumenthal*, 282 Mass. 1, 184 N. E. 279; *Maeder Steel Products Co. v. Zanello*, 109 Or. 562, 220 P. 155; *Creitz v. Bennett*, 350 Ill. 32, 182 N. E. 736; *City Dairy Co. v. Uservo*, 101 Ind. App. 375, 199 N. E. 457. The Board appropriately gave the "law merchant" as an example of a custom which has acquired the force of law (App. 17).

The inquiry naturally arises as to why, if, as used in the statute, the word "customs" is more or less synonymous with the word "law", it was necessary to include the words "customs" and "ethics" as well as the word "law". The obvious answer is that Congress must have recognized that there were certain occupations which, although not specifically prohibited by law in the sense that that word connotes a statute or the common law, could nevertheless not be carried on by corporations.

It will be noticed that, while under statutes in force in the District of Columbia the practice of certain professions has been limited to individuals,² there is no statute in force to prohibit corporations from, for example, engaging in the practice of law. Thus, but for the inclusion of the words "customs" and "ethics" in the statute, lawyers

² See, for example, Secs. 2-301, 2-701 and 2-904, D. C. Code, 1940.

would, under the statute, be held to be engaged in a trade or business which could be carried on by corporations. It is reasonable to assume, therefore, that Congress included the words "customs" and "ethics" so as to exclude from the words "unincorporated business" certain learned professions embracing the highest degree of fiduciary relationship between the one seeking the professional services and the one rendering the same. However, stockbrokerage, as we shall see, does not fit within that class.

"Properly speaking, a stockbroker is one who buys and sells shares in a corporation; one who deals in the stock of moneyed corporations or in other securities; one employed to buy and sell shares of stock in incorporated companies and the indebtedness of governments; one who deals in the stock of moneyed corporations and in other securities for his principal."³ It is undoubtedly true that a stockbroker is in more of a fiduciary relationship with his principal than is an ordinary broker. *Esmar v. Haeussler*, 115 S. W. 2d 54, 61. It is elementary that a broker, including a stockbroker, is an agent. That a corporation may act as an agent or broker can not be disputed,⁴ although, generally speaking, a corporation may not engage in the practice of a learned profession.⁵

Those professions which by custom and ethics can not be engaged in by corporations are those learned professions wherein is created a personal relationship which can not exist between the persons employing the professional services and profit-seeking corporations. *Silver v. Lansburgh & Bro.*, 72 App. D. C. 77, 111 F. 2d 518. There is no such personal relationship between a stockbroker and his principal and, to repeat, it is the business of stockbrokers

³ 12 C. J. S., Brokers, Sec. 1, p. 7.

⁴ *In re Kentucky Wagon Mfg. Co.*, 3 F. Supp. 958, aff'd 71 F. 2d 802, cert. den. sub. nom. *Laurent v. Stites*, 293 U. S. 612, 79 L. Ed. 701, 55 S. Ct. 142.

⁵ *Merrick v. American Security & Trust Co.*, 71 App. D. C. 72, 107 F. 2d 271, cert. den. 308 U. S. 625, 84 L. Ed. 521, 60 S. Ct. 380; 19 C. J. S., Corporations, Sec. 956b, p. 404.

with which we are here concerned and not membership in the New York or any other stock exchange.

It goes without saying that Congress is presumed to have knowledge of the customs and usages of any particular trade when it enacts legislation affecting such trade. In the Securities Exchange Act of 1934, 48 Stat. 881, 882, ch. 404, Sec. 3, Congress defined the term "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others" and defined the word "person" to mean "an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization."

In Rule X-17A-5 of the General Rules and Regulations of the Securities and Exchange Commission, which relates to reports to be made by certain exchange members, brokers and dealers, it is stated, *inter alia*, that "If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer." It would be, respondent submits, a most ridiculous sort of situation if an agency of the Federal Government created by an Act of Congress should promulgate a regulation requiring annual reports of members of stock exchanges, brokers, or dealers to be filed by a duly authorized officer of a corporation if by custom, in the sense that custom has the force of law, a corporation were prohibited from acting as a stockbroker.

On page 25 of their brief, petitioners state that "In passing it is significant to note that in a nation-wide poll taken of its members this year, the New York Stock Exchange again voted down overwhelmingly a proposal to amend its by-laws to allow corporations to become members." While there is nothing in the evidence with respect to any such poll, respondent does not object to its inclusion in petitioners' brief, as we feel certain that the purpose of petitioners in so including this statement was to make available

to this Court all pertinent information. Along the same line, respondent believes that, in passing, it is significant to note that there appears to have been created a new stock exchange known as the "Midwest Stock Exchange" to operate in competition with the New York Stock Exchange, and which, unlike the New York Stock Exchange, it is reported, "will welcome small-town incorporated investment houses" to membership. (Supplement to Brief, *infra*, p. 14.)

As a matter of fact, one of these petitioners recognized the fact that at least one corporation had within recent years been engaged in business in the District of Columbia as a stockbroker (App. to this brief, p. 11).

CONCLUSION

It is submitted that the decision of the Board in this case was correct and should be affirmed.

Respectfully,

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APPENDIX

Excerpts from Testimony

Paul P. Rodler:

49 By Mr. Walker:

* * * * *

Q. * * * Do you know, as a fact, that Ferris & Company, Incorporated, was engaged in business in the District of Columbia as stockbrokers, prior to the creation of the partnership? A. Yes, I knew that.

50 Q. Of course, it requires membership in no Exchange to make over-the-counter transactions or to act as brokers for over-the-counter sales, does it? A. The only requirement is you register with the SEC.

* * * * *

The Board: All right. I would like to ask you this: In order to buy securities from a dealer you do not have to be a member of an Exchange at all, do you?

51 The Witness: No.

* * * * *

By Mr. Walker:

Q. You mentioned, Mr. Rodler, the Securities and Exchange Commission. Are you familiar with the Securities Exchange Act of 1933? A. I think I am.

Q. Are you aware of the fact that in that Act the term "broker" is defined to mean this:

"Any person engaged in business of effecting transactions in securities for the account of others, but that does not include a bank."?

A. Yes.

Q. Are you also familiar with the fact that the term "person" is defined in that Act to mean this: "means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization"? A. Yes.

Q. So that under the Securities Exchange Act a broker could, in fact, be any of those entities? A. Yes.

Q. Was W. B. Hibbs & Co. in 1947 registered as a broker with the Securities and Exchange Commission? A. It was.

* * * * *

Q. * * * I will ask the question again: Do you know whether or not any corporations were registered as security brokers with the Securities and Exchange Commission in 1947? A. Yes.

The Board: Are you answering the question that you do not know or is it a fact?

The Witness: Yes, from this book, I would say it is a fact.

* * * * *

55 By Mr. Walker:

Q. Would you have earned anything by the mere fact of your membership in the New York Stock Exchange?

The Board: Of course he would not have earned anything.

* * * * *

SUPPLEMENT TO BRIEF

Excerpts from "Business Week", a weekly periodical published by McGraw-Hill Publishing Company, Inc., 330 W. 42nd Street, New York 18, New York.

(Washington Bureau, National Press Building, Washington, D. C.)

From "Business Week", Aug. 27, 1949:

"WALL ST. QUALMS

"Merger of Midwest exchanges is now set for next month. N. Y. traders wonder about loss of business.

"Wall Street has begun to worry a little bit about the merger of midwestern stock exchanges (BW—Jun. 4'49, p88). The long-talked-of linkup of the Chicago, Cleveland, St. Louis, and Minneapolis-St. Paul exchanges was definitely set last week for Sept. 15. Cincinnati will vote on coming in Sept. 12. Now some Streeters are wondering if they will feel the competitive pinch.

“ ● REGIONAL LOSS—For one thing, they may lose some of the trading in local issues. The new market will specialize in these regional corporation shares. A combined, centralized trading center should be in a good position to siphon off some of the business from the Big Board.

"Another thing that needles some Streeters is the fact that members of the new board will be able to engage in 'unrestricted trading' off the board in certain inactive stocks. These more liberal trading rules will give members of the Chicago market a better chance to buck over-the-

counter competition. *And, unlike the Big Board, which restricts membership to unincorporated brokerage houses, the new market will welcome small-town incorporated investment houses. It will also take in big incorporated underwriting companies that have large stock trading facilities.*

“ ● STILL NAMELESS—Even though the merger becomes effective next month, the new board won't start operating much before mid-November. Getting its headquarters set up in the present Chicago exchange will take time. And there is still the business of deciding on a name.

“Nominating committees, though, have already been picked to choose the initial board of governors. And within 60 days after the merger, the members will make their choice of a name.

“ ● BARGAIN RATES—During the same 60-day period, corporations that now have stocks listed on the participating boards can transfer their listings to the new exchange without charge. And until the deadline, members of the various exchanges can buy memberships on the new board for \$2,500. After Nov. 15, the seats will be sold only on the open market.

“Last week, a bull market in seats on the Chicago Stock Exchange showed the traders had high hopes for the new mart. In a few days, the price jumped from about \$3,300 to \$4,100.” (*Italics supplied.*)

From “Business Week”, Sept. 3, 1949, p. 71:

“Midwest Stock Exchange will be the name of the four midwestern exchanges that are merging (BW—Aug. 27 '49, p 66). It will accept memberships and listings beginning Sept. 15.”

From "Business Week", Oct. 29, 1949, p. 87:

"INTENT TO COMPETE

"Midwest Stock Exchange is set to fight Wall Street—particularly the big wire houses—for security business.

"Wall Street's fears about the Midwest Stock Exchange (BW—Aug. 27'49, p66) seemed confirmed last week. The new exchange, which starts operations in mid-December, has no idea of living off the crumbs that drop from Wall Street's table.

● **COMPETITION**—That was the word from James E. Day, president of the Chicago Stock Exchange. Day was a leader in the talks that brought about the merger of his exchange with those in Minneapolis-St. Paul, Cleveland, and St. Louis.

" 'New York apparently doesn't like competition,' he said, 'but we fully intend to compete.'

"Day's warning was aimed at Wall Street's big wire houses—not the New York Stock Exchange. These wire houses have branch offices throughout the Midwest; they, thus, gobble up much of the region's business.

"As far as the Big Board goes, Day admits it is the logical national market for securities. He has no objection to local securities moving to the New York exchange when the size of the issuing company demands a broad market.

"But he says, 'We intend to retain a Midwest market in midwestern securities until these corporations are ready for the national market in New York.' And, 'we intend to continue this Midwest market after that in the interest of midwestern stockholders who for economic and other reasons prefer to do business here.'

● **IMPLANT, NOT DILUTE**—Emil Schram, president of the New York Stock Exchange, doesn't expect any conflict—provided Midwest moves toward 'implanting' rather than 'diluting' the New York market.

"Schram admits there are some who would be 'displeased' if the new market started to take much business from Wall Street. However, the big loser from 'any dilution of the listed market in New York would be those who buy and sell securities. The greatest market is where there is the largest concentration of trading,' Schram said.

" ● UNLISTED ISSUES—New York, though, is bound and determined not to let any of its business go by default. As Schram sees it, the success of the new exchange will hinge mainly on its ability to attract listings of hitherto unlisted securities. These listings, Schram warned, may be tough to get.

"Another important factor is the lack of Chicago transfer agents for many New York-listed midwestern stocks. If the shortage could be rectified, it would probably stimulate local trading in many issues now listed on the Big Board. On stock sales New York collects a transfer tax which runs as high as \$4 per 100 shares; there is no such tax in Illinois."

From "Business Week", Dec. 10, 1949, p. 76:

"The Midwest Stock Exchange (BW—Oct. 29 '49, p 87) has opened for business with 409 stocks listed and 358 members. Sales so far have been encouraging."

Excerpt from CCH Federal Securities Law Reporter

"Sec. 6(a). Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified: * * *"

Securities Exchange Act of 1934—See 2 CCH Federal Securities Law Reporter, ¶ 22,291, p. 13,161.

“.01. Registered and Exempt Exchanges.—The following exchanges are registered under the provisions of Sec. 6(a) :

* * * * *

“Midwest Stock Exchange

* * * * *

“New York Stock Exchange

* * * * *

“Washington (D. C.) Stock Exchange

* * * * *

2 CCH Federal Securities Law Reporter, ¶
22,291.01, p. 13,161.